

Estimated Sustainable Growth Rate and Conversion Factor, for Medicare Payments to Physicians in 2007

Section 1848(d)(1)(E) of the Social Security Act (the Act) requires the Secretary to make available to the Medicare Payment Advisory Commission (MedPAC) and the public by March 1, an estimate of the Sustainable Growth Rate (SGR) and conversion factor applicable to Medicare payments for physicians' services for the following year and the data underlying these estimates. Earlier in 2006, we provided the estimates and information applicable to physician fee schedule payments in calendar year 2007 in a letter to MedPAC and to the public via this web page. We are now updating the web page to be consistent with information contained in the physician fee schedule final rule for 2007 issued on November 1, 2006, and to provide updated expenditure data. It is important to note that the SGRs are *estimated* and may be revised based on later data.

Medicare Sustainable Growth Rate

Section 1848(f) of the Social Security Act (the Act), as amended by section 4503 of the Balanced Budget Act of 1997 (BBA) (Pub. L. 105-33), enacted on August 5, 1997, replaced the Medicare Volume Performance Standard (MVPS) with a Sustainable Growth Rate (SGR) provision. Section 1848(f)(2) of the Act specifies the formula for establishing yearly SGR targets for physicians' services under Medicare. The use of SGR targets is intended to control the growth in aggregate Medicare expenditures for physicians' services.

The SGR targets are not direct limits on expenditures. Payments for services are not withheld if the SGR target is exceeded by actual expenditures. Rather, the fee schedule update, as specified in section 1848(d)(4) of the Act, is adjusted to reflect the comparison of actual expenditures to target expenditures. If expenditures exceed the target, the update is reduced. If expenditures are less than the target, the update is increased. Under the statute, the update for a year is determined by comparing cumulative actual expenditures to cumulative target expenditures (referred to as "allowed expenditures" in the statute) from April 1, 1996 through the end of the year preceding the year at issue. For instance, the 2007 update will reflect a comparison of cumulative actual to cumulative target expenditures from April 1, 1996 through December 31, 2006. Target expenditures for each year are equal to target expenditures from the previous year increased by the SGR (which is a percentage figure computed by combining four factors specified below).

The statute specifies a formula to calculate the SGR based on our estimate of the change in each of four factors. The four factors for calculating the SGR are as follows:

- (1) The estimated percentage change in fees for physicians' services.
- (2) The estimated percentage change in the average number of Medicare fee-for-service beneficiaries.
- (3) The estimated 10-year average annual percentage change in real gross domestic product (GDP) per capita.
- (4) The estimated percentage change in expenditures due to changes in law or regulations.

Prior to enactment of the Medicare Prescription Drug, Improvement and Modernization Act (also known as the Medicare Modernization Act, or MMA), the statute required the SGR to be calculated using estimated projected growth in real GDP per capita. That is, the Secretary was required to use an estimate of a single year's real GDP per capita to determine the SGR. However, section 1848(f)(2)(C) of the Act, as amended by section 601(b) of the MMA, requires the Secretary to calculate the SGR using the 10-year annual average growth in real gross domestic product per capita.

Section 1848(d)(1)(E) of the Act requires publication in the *Federal Register* no later than November 1 of each year (beginning with 2000) of the actual conversion factor, update and allowed expenditures that will apply to physicians' services for the succeeding year. Another section of the law (section 1848(f)(1)) requires that we publish in the *Federal Register* no later than November 1 of each year, using the best available data as of September 1, the SGR for the following year, the contemporaneous year, and the preceding year. Based on the best data available to us as of September 1, 2006, the SGRs for CY 2005, CY 2006, and CY 2007 were included in the physician fee schedule final rule for 2007 issued on November 1, 2006. In that final rule, we provided (i) the final figure for the CY 2005 SGR, and our current estimates of the SGRs for CY 2006, and CY 2007, (ii) our current estimate of allowed expenditures

under the SGR system through the end of 2007, and (iii) the physician fee schedule update and conversion factor for 2007.

Table 1 shows our current estimates of the aforementioned SGRs.

Table 1. Current Estimates of SGRs for CY 2005, CY 2006, and CY 2007

	CY 2005	CY 2006	CY 2007
Factor 1: Increase in Fees	0.8%	2.2%	2.2%
Factor 2: Increase in Enrollment	0.3%	-2.2%	-0.9%
Factor 3: Increase in 10-year moving average Real Per Capita GDP	2.1%	2.1%	2.0%
Factor 4: Increase due to changes in Law or Regulations	0.9%	0.0%	-1.5%
Total Sustainable Growth Rate	4.2%	2.1%	1.8%

There may be differences between the initial estimate of the SGR for a year, a subsequent reestimate based on later data, and the final revision once the year is complete. Section 1848(f)(3) of the statute, as amended by section 211 of the BBRA, requires the adjustment of prior years' SGR component factors, to reflect later data, beginning with the SGR for FY 2000. The statute requires the final revision to the SGR for a given year be done the following year. Thus, consistent with the statute, we made the final revisions to the CY 2005 SGR in the physician fee schedule final rule issued November 1, 2006. The two SGR elements that have exhibited the most volatility have been the fee-for-service enrollment numbers and real gross domestic product per capita.¹

The MVPS/SGR targets for periods prior to CY 2005 are considered to be final, since no legislative authority exists to adjust the promulgated amounts using later data. These targets are listed in Table 2 below. The MVPS applied for FY 1990 through FY 1997. The SGR applied beginning with FY 1998. Figures reflect a weighted average MVPS for FY 1991 through FY 1993 when there were two different MVPSs (one for surgical services, and one for all other services) and for FY 1994 through FY 1997 when there were three different MVPSs (for surgical services, primary care services, and all other services).

Table 2 Physician MVPS / SGR

Year	Physician MVPS / SGR
FY 1990	9.1%
FY 1991	7.3%
FY 1992	10.0%
FY 1993	10.0%
FY 1994	9.4%
FY 1995	7.5%
FY 1996	1.8%
FY 1997	-0.3%
FY 1998	3.2%
FY 1999	4.2%
FY 2000	6.9%
CY 2000	7.3%
CY 2001	4.5%
CY 2002	8.3%
CY 2003	7.3%
CY 2004	6.6%
CY 2005	4.2%

¹ We note that more recent data on these two elements are available during a year on several web sites. The latest measurements of real GDP for a quarter is available from the home page for the Bureau of Economic Analysis of the Department of Commerce (www.bea.doc.gov). Population figures are available from the home page for the Census Bureau (www.census.gov). Real GDP per capita can be calculated from these figures. In April of each year, when our Office of the Actuary puts the Trustees Report on the CMS Home page, we will also post the projections of total Medicare Part B enrollment and of Medicare managed care enrollment for the current and subsequent calendar years, as well as for the preceding calendar year, consistent with the Trustees Report. Thus, Medicare fee-for-service enrollment could be determined.

Allowed Expenditures for Physicians' Services

Section 1848(d)(3)(C) of the Act defines allowed expenditures for the period April 1, 1996 through March 31, 1997 to be equal to actual expenditures for physicians' services during that period. Annual allowed expenditures for subsequent periods are equal to annual allowed expenditures for the previous year increased by the SGR. The BBRA provided for a transition from a fiscal year to a calendar year SGR system. Beginning with CY 2000, the SGR is determined on a calendar year basis. We have described this transition in a notice that appeared in the *Federal Register* on April 10, 2000.

Table 3 shows quarterly allowed expenditures and cumulative allowed expenditures for the period from April 1, 1996 through December 31, 2007. The table shows quarterly allowed expenditures for physicians' services to reflect any seasonality, which may occur in expenditures for physicians' services over a year. For instance, there is a different figure for quarterly allowed expenditures for the four quarters included in the April 1, 1996 to March 31, 1997 base period. We provide more information below on how quarterly figures are combined to determine allowed expenditures for a year.

Table 3. Summary of Allowed Expenditures for Physicians' Services¹

Quarter	Applicable SGR	Quarterly Allowed Expenditures ² [in billions]	Cumulative Allowed Expenditures ³ [in billions]
2Q1996		\$12.4	\$12.4
3Q1996		\$12.0	\$24.3
4Q1996		\$12.2	\$36.6
1Q1997		\$12.3	\$48.9
2Q1997	3.2%	\$12.7	\$61.7
3Q1997	3.2%	\$12.4	\$74.0
4Q1997	3.2%	\$12.6	\$86.7
1Q1998	3.2%	\$12.7	\$99.4
2Q1998	4.2%	\$13.3	\$112.7
3Q1998	4.2%	\$12.9	\$125.6
4Q1998	4.2%	\$13.2	\$138.7
1Q1999	4.2%	\$13.3	\$152.0
2Q1999	6.9%	\$14.2	\$166.2
3Q1999	6.9%	\$13.8	\$180.0
4Q1999	6.9%	\$14.1	\$194.0
1Q2000	7.3%	\$14.2	\$208.3
2Q2000	7.3%	\$15.2	\$223.5
3Q2000	7.3%	\$14.8	\$238.3
4Q2000	7.3%	\$15.1	\$253.4
1Q2001	4.5%	\$14.9	\$268.3
2Q2001	4.5%	\$15.9	\$284.2
3Q2001	4.5%	\$15.4	\$299.6
4Q2001	4.5%	\$15.8	\$315.4
1Q2002	8.3%	\$16.1	\$331.5
2Q2002	8.3%	\$17.2	\$348.8
3Q2002	8.3%	\$16.7	\$365.5
4Q2002	8.3%	\$17.1	\$382.6
1Q2003	7.3%	\$17.3	\$399.9
2Q2003	7.3%	\$18.5	\$418.4
3Q2003	7.3%	\$17.9	\$436.3
4Q2003	7.3%	\$18.3	\$454.6
1Q2004	6.6%	\$18.4	\$473.1
2Q2004	6.6%	\$19.7	\$492.8
3Q2004	6.6%	\$19.1	\$511.9
4Q2004	6.6%	\$19.5	\$531.5
1Q2005	4.2%	\$19.2	\$550.7
2Q2005	4.2%	\$20.6	\$571.2
3Q2005	4.2%	\$19.9	\$591.2
4Q2005	4.2%	\$20.4	\$611.5
1Q2006	2.1%	\$19.6	\$631.1
2Q2006	2.1%	\$21.0	\$652.1
3Q2006	2.1%	\$20.4	\$672.5
4Q2006	2.1%	\$20.8	\$693.3
1Q2007	1.8%	\$20.0	\$713.2
2Q2007	1.8%	\$21.4	\$734.6
3Q2007	1.8%	\$20.7	\$755.3
4Q2007	1.8%	\$21.2	\$776.5

¹As explained above, pursuant to the BBRA, the SGRs for FY2000, CY 2000, and all subsequent years are estimated and subsequently revised twice, based on later data. The 2006 figures (based on the CY 2006 SGR), and the 2007 figures (based on the 2007 SGR) are estimated and may change based on more recent information which affects these SGRs.

²Allowed expenditures for a quarter (such as 4Q2007) are equal to allowed expenditures for the same quarter in the previous year (4Q2006 in this example) increased by the SGR for the year in which that quarter occurs (in this case, 1.8 percent). For example, quarterly allowed expenditures of \$21.2 billion in 4Q2007 are equal to quarterly allowed expenditures of roughly \$20.8 billion (4Q2006) increased by the SGR of 1.8 percent (\$21.2 billion = \$20.8 billion x 1.018).

³Cumulative allowed expenditures for a quarter (such as 4Q 2007) are equal to the sum of cumulative allowed expenditures from the previous quarter for the same year (3Q2007) and quarterly allowed expenditures for that quarter. For example, cumulative allowed expenditures in 4Q2007 of \$776.5 billion are equal to the sum of cumulative allowed expenditures through 3Q2007 of \$755.3 billion and estimated allowed expenditures in 4Q2007 of \$21.2 billion (\$776.5 billion = \$755.3 billion + \$21.2 billion).

Note: Totals do not necessarily equal the sum of rounded components.

Actual Expenditures for Physicians' Services

Table 4 shows, on a quarterly basis from April 1, 1996 through June 30, 2006, actual expenditures and cumulative actual expenditures for the period. These expenditures represent reimbursement amounts tabulated by the quarter in which the service was furnished. Since there is a lag between the date that the service is furnished and the date that the payment is made, the most recent quarters depict incomplete data. The total reimbursement amounts for these quarters are estimated by approximating the level of completeness of the data. This approximation is determined using historical trends. We will update these amounts periodically when we have reasonably complete data (approximately 6 months after the end of a quarter). As we have described above, we are showing actual expenditures on a quarterly basis to reflect any seasonal variation in expenditures that occurs over the year.

Table 4. Summary of Actual Expenditures under the SGR

Calendar Quarter	Benefits Processed thru 12/31/05 [in billions]	Approximate Completeness	Estimated Total Expenditures ¹ [in billions]	Cumulative Total Expenditures ¹ [in billions]
2Q1996	\$12.4	100.0%	\$12.4	\$12.4
3Q1996	\$12.0	100.0%	\$12.0	\$24.3
4Q1996	\$12.2	100.0%	\$12.2	\$36.6
1Q1997	\$12.3	100.0%	\$12.3	\$48.9
2Q1997	\$12.6	100.0%	\$12.6	\$61.5
3Q1997	\$12.2	100.0%	\$12.2	\$73.6
4Q1997	\$12.2	100.0%	\$12.2	\$85.8
1Q1998	\$12.5	100.0%	\$12.5	\$98.4
2Q1998	\$12.6	100.0%	\$12.6	\$111.0
3Q1998	\$12.3	100.0%	\$12.3	\$123.3
4Q1998	\$12.5	100.0%	\$12.5	\$135.8
1Q1999	\$13.1	100.0%	\$13.1	\$148.9
2Q1999	\$13.3	100.0%	\$13.3	\$162.2
3Q1999	\$13.0	100.0%	\$13.0	\$175.2
4Q1999	\$13.2	100.0%	\$13.2	\$188.4
1Q2000	\$14.5	100.0%	\$14.5	\$202.9
2Q2000	\$14.6	100.0%	\$14.6	\$217.5
3Q2000	\$14.4	100.0%	\$14.4	\$232.0
4Q2000	\$14.5	100.0%	\$14.5	\$246.5
1Q2001	\$16.3	100.0%	\$16.3	\$262.8
2Q2001	\$16.7	100.0%	\$16.7	\$279.5
3Q2001	\$16.4	100.0%	\$16.4	\$295.9
4Q2001	\$16.9	100.0%	\$16.9	\$312.8
1Q2002	\$17.2	100.0%	\$17.2	\$330.0
2Q2002	\$17.9	100.0%	\$17.9	\$347.9
3Q2002	\$17.8	100.0%	\$17.8	\$365.7
4Q2002	\$18.0	100.0%	\$18.0	\$383.7
1Q2003	\$18.7	100.0%	\$18.7	\$402.4
2Q2003	\$19.8	100.0%	\$19.8	\$422.2
3Q2003	\$19.8	100.0%	\$19.8	\$442.0
4Q2003	\$19.9	100.0%	\$19.9	\$461.9
1Q2004	\$21.3	100.0%	\$21.3	\$483.2
2Q2004	\$21.9	100.0%	\$21.9	\$505.1
3Q2004	\$21.9	100.0%	\$21.9	\$527.0
4Q2004	\$22.0	99.9%	\$22.1	\$549.0
1Q2005	\$22.8	99.8%	\$22.8	\$571.9
2Q2005	\$23.4	99.5%	\$23.5	\$595.4
3Q2005	\$22.7	99.1%	\$22.9	\$618.3
4Q2005	\$22.2	98.1%	\$22.7	\$641.0
1Q2006	\$22.6	95.6%	\$23.6	\$664.6
2Q2006	\$17.7	73.1%	\$24.2	\$688.8

¹Estimated and cumulative total expenditures are less likely to change as the approximate completeness approaches 100 percent.

Note: Totals do not necessarily equal the sum of rounded components.

CY 2007 Physician Fee Schedule Update and Conversion Factor

The physician fee schedule update for CY 2007 is determined according to a statutory formula by multiplying (i) the Medicare Economic Index (MEI), and (ii) the update adjustment factor (UAF) as shown in table 5 ($0.950 = 1.021 \times 0.930$). The MEI measures the weighted average price change for various inputs involved with producing physicians' services. The update adjustment factor compares actual and target expenditures, and, for a given year, is determined by a formula, as shown below.

$$UAF_{2007} = \frac{\text{Target}_{2006} - \text{Actual}_{2006}}{\text{Actual}_{2006}} \times 0.75 + \frac{\text{Target}_{4/96-12/06} - \text{Actual}_{4/96-12/06}}{\text{Actual}_{2006} \times (1 + \text{SGR}_{2007})} \times 0.33$$

Substituting the estimated figures from tables 1, 3, and 4, as well as our current projections of actual expenditures for CY 2006 (summarized below) in this formula produces our current estimate of the UAF for 2007:

Target₀₆ = Estimated Allowed Expenditures for CY 2006 = \$81.7 billion (\$19.6 + \$21.0 + \$20.4 + \$20.8)

Actual₀₆ = Estimated Actual Expenditures for CY 2006 = \$94.9 billion

Target_{4/96-12/06} = Estimated Cumulative Allowed Expenditures from 4/1/96 - 12/31/06 = \$693.3 billion

Actual_{4/96-12/06} = Estimated Cumulative Actual Expenditures from 4/1/96 - 12/31/06 = \$735.9 billion

SGR₂₀₀₇ = Estimated Sustainable Growth Rate for 2007 = 1.8 percent or 0.018

$$UAF_{2007} = \frac{81.7 - 94.9}{94.9} \times 0.75 + \frac{693.3 - 735.9}{94.9 \times 1.018} \times 0.33 = -0.250 = -25.0\%$$

Since section 1848(d)(3)(D) of the Act does not allow the update adjustment factor for a given year to be greater than 3.0 percentage points nor less than -7.0 percentage points, the UAF for 2007 is -7.0 percentage points. For 2007, the update adjustment factor is then multiplied by the MEI of 2.1 percent (1.021) for 2007, to determine the physician update for 2007, -5.0 percent (.950).

Section 1848(c)(2)(B)(ii) of the Act requires that we make changes to relative value units in a budget-neutral manner. We ensure budget neutrality either by adjusting the conversion factor, rescaling the relative value units directly, or applying a separate scaling factor to the relative value units when calculating payments. For 2007, we are ensuring budget neutrality through adjustments to relative value units and through a separate scaling factor applied to the relative value units when calculating payments, not through an adjustment to the conversion factor.

Each year, the physician fee schedule conversion factor is increased by the product of the physician update (.950), and any budget-neutrality RVU adjustment to the conversion factor (none for 2007). This increase, when applied to the CY 2006 conversion factor of \$37.8975, produces a conversion factor for CY 2007 of \$35.9848.

Table 5. CY 2007 Physician Fee Schedule Conversion Factor

CY 2006 Conversion Factor	\$37.8975
MEI	2.1% (1.021)
Update Adjustment	-7.0% (0.930)
CY 2007 Update	-5.0% (0.950)
CY 2007 Conversion Factor	\$35.9848

Table 6 lists the historical MEI and physician updates from 1992 through 2007. The physician update reflects a weighted average for 1993 when there were two different updates (one for surgery and one for other services). The

physician update reflects a weighted average for 1994 through 1998 when there were three different updates (for surgery, primary care, and other services).

Table 6. Actual Past Medicare Economic Index Increases and Physician Updates for 1992-2007

Year	Physician Medicare Economic Index Increase	Physician Update
Actual:		
1992	3.2%	1.9%
1993	2.7%	1.4%
1994	2.3%	7.0%
1995	2.1%	7.5%
1996	2.0%	0.8%
1997	2.0%	0.6%
1998	2.2%	2.3%
1999	2.3%	2.3%
2000	2.4%	5.5%
2001	2.1%	5.0%
2002	2.6%	-4.8%
2003	3.0%	1.7%
2004	2.9%	1.5%
2005	3.1%	1.5%
2006	2.8%	0.2%
2007	2.1%	-5.0%
<u>Average Annual</u>		
1992-2007	2.5%	1.8%
1998-2007	2.5%	0.9%
<u>Cumulative</u>		
1992-2007	48.1%	32.2%

Note: The update of 1.7% for 2003 was effective on March 1, 2003; therefore the average update for that year was 1.4%. For 2006, the Deficit Reduction Act froze the physician fee schedule conversion factor. The conversion factor freeze, together with refinements to the relative value units, resulted in an update of 0.2 percent for 2006.

Questions on the information presented here may be addressed to:

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November 2006